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Summary:
Metso Corp.

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Table Of Contents

Summary:

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Credit Rating: BBB/Stable/A-2

Rationale

The ratings on Finland-based Metso Corp. reflect its satisfactory business profile, underpinned by leading market positions in its core businesses of pulp and paper machinery and rock and minerals processing; a geographically diversified earnings base; and improved operating performance. This is balanced by exposure to cyclical demand and price competition in both core businesses and limited end-user industry diversification. The financial risk profile is intermediate, in line with the rating level.

At June 30, 2007, Metso's adjusted debt reached about €1.06 billion (including estimated postretirement liabilities and operating leases of about €265 million, and a deduction of about €60 million in excess cash) following weak quarterly free cash generation and dividend payments. Although underlying cash generation is strong, debt could increase due to potential share buybacks and acquisitions. Meanwhile, Standard & Poor's Ratings Services believes that the risk of a break-up of the group is limited at present.

Metso has demonstrated consistent earnings growth and ongoing operating improvement, although margins have been affected in recent quarters by raw material price inflation and project deliveries. The group's EBIT margin reached 8.8% in the first half of 2007, compared with 9.2% for the full-year 2006. Demand is strong in the minerals segment and stable in the paper segment. In the first half of 2007, group orders and the order backlog grew 33% and 60%, respectively, year on year. We still expect earnings to be volatile through the cycle, but Metso's reduced cost base and growing aftermarket and maintenance sales have reduced this exposure.

Improved profitability and debt reduction, helped by the current favorable business conditions, have enhanced Metso's debt-protection measures, which are strong for the rating. Despite the late payment for, and consolidation of, the acquisition of Aker Kvaerner (and hence no cash flow benefit), funds from operations (FFO) to adjusted debt was about 56% in 2006 (46% in 2005), while adjusted debt to capital was about 38% (40% in 2005). These ratios were estimated at 50% and 42%, respectively, on a 12 month basis at June 30, 2007.

Short-term credit factors

The short-term rating is 'A-2', reflecting satisfactory liquidity resources. At June 30, 2007, Metso's committed credit facilities of €500 million were unused. The group also had €223 million in cash and equivalents. This compares with short-term debt of €273 million. Metso's long-term credit facility, which matures in 2011, is subject to financial covenants, although the group should remain comfortably in compliance with these requirements. In addition, the group has flexibility in capital expenditure, with no large investment projects planned over the short term. Standard & Poor's expects the group to generate positive free operating cash flow over the medium term of at least €150 million per year (about €280 million in 2006).

Outlook

The stable outlook incorporates a degree of weakening in Metso's financial performance over the medium to long term, reflecting the potential impact of bolt-on acquisitions, higher dividends, and the cyclicality of the group's business. At the 'BBB' level, Metso should achieve average adjusted FFO to debt of 30% over the cycle. A revised shareholder distribution policy announced in the second half of 2006 is in line with the rating.

Upward movement in terms of outlook or rating changes would be considered if Metso's medium-term financial performance and future prospects continue to remain high for the rating level. For a rating upgrade, we would also require the group to continue to demonstrate its commitment to a prudent financial policy, including that related to dividends and balance-sheet structure.

Downside risk primarily relates to potential large debt-financed acquisitions that could negatively affect the group's business and financial risk profiles, especially if combined with deteriorating business conditions and difficulties in adjusting the cost structure. Any significant negative changes to Metso's financial or business structure resulting from a change of strategic direction is considered an event risk.

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